THE MAN WITH THE PLAN: 6 QUESTIONS FOR ALAN BUERGER

Alan Buerger, CEO and co-founder of Coventry, is the single most influential figure in the secondary market for life insurance. An industry veteran of more than 30 years, Buerger has used Coventry to spearhead the life settlement business, all while deflecting criticism and legal challenges to the business practice of selling unwanted life insurance in a free market environment. In this exclusive interview with *National Underwriter Life & Health*, Buerger discusses how he got the idea to start Coventry, where STOLI ends and life settlements begin, and what challenges the secondary market continues to face.

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#1 What gave you the idea to start Coventry?

Just by way of background, I have been in the life insurance business for 40 years and have done almost everything there is to do in the life insurance business. I specialized in disability insurance. I sold life insurance payroll deduction in the middle of the night. We sold group insurance, annuities and over time, we became experts at dealing with people who were of high net worth or ultra-high net worth. Eventually we helped a half a dozen companies with their early development of their second-to-die policies. We then moved into the corporate-owned life insurance market and became one of the largest firms in the country in that business. During that time, every year or two, legislation passed that made COLI a little attractive. We always invested a good portion of our capital back into research and development and we worked with CNA life insurance company to develop a COLI product. They had a subsidiary that was in the viatical business—individuals that were terminally ill (generally young men) — a business we weren't in and never had an interest to be in. The viatical market was going away due to medical advancements. So, we met with the officers of that company and they were trying to get involved with what has become life settlements. However, they really didn't have access to the large marketing firms, but we did, because we had been involved in COLI. Within a week, we had taken them into large market-

ing firms and contracted them and started to develop the market.

It was very simple: we provide enormous value to consumers. The first time we bought policies was in the early 1990s, when several insurance companies were going under, and as an accommodation to clients, we bought the policies for the cash surrender value because when a company would go into rehab, although the carriers would pay the death benefits, the policy holders could not surrender the policies. So as an accommodation, we bought life policies and annuities for the cash. We would hold them until the companies came out of rehabilitation and the asset was free and clear. At that point, it occurred to me that there was an opportunity for a business to provide value to consumers who really did not have any choice. I learned a word back then and that word is *monopsony*. It is a circumstance when there is only one buyer for a seller and in this case it is the carriers. I realized that if someone bought a home from a developer and lived there 10 years and then wanted to sell the home, if the only person they could go to do was the developer, that does not put that person in very good place to negotiate. In fact, it puts them in no place to negotiate. That is the same circumstance for the secondary market. This is property, a life insurance policy is property, the courts have said that. When it is suitable, a life settlement is a very powerful option.

Personally I am a very strong believer in life insurance and I believe in the legacy and the impact on the community that a life insurance agent provides. I believe it is a very noble profession. I believe that people should keep their life insurance policies, but if they are not going to keep it—and a large majority are not going to keep it—then the option of a life settlement gives them more options. They can, if it is suitable, get better value than they could from the insurance company. Coventry First was started out of what I saw as a real need for consumers and we actually took a mortgage out on our home to acquire policies and eventually developed a relationship with institutional investors.

#2 In *Grisby v Russell* 222, the U.S. Supreme Court stated back in 1911 that the business model for any life settlement company was Constitutionally sound. So why did it take so long for the formal market to develop?

It took that long because the carriers had to create the opportunity. Policies could always be bought and sold to individuals since there was the first court case over it in 1854.

I started in the business as a career agent with Mutual of New York and I was taught to sell, and I did sell, whole life insurance. Whole life insurance by definition, is a policy that at the age of 95 or 100 the guaranteed cash value will equal the face amount, which is to say that every year there is a increasing amount of cash surrender value. Our business [life settlements] is to beat cash surrender value, to pay more than what they would get if they were to surrender. With whole life, that means that they have to be very ill. It.

Now, there are two real factors as to why it took so long. One is it was not until 1980 that the life industry created universal life. Universal life, over time, was sold to have minimum cash value (originally it was created to have a lot of cash value). The second reason that the market came about was because the carriers got out of the business of career agents. With a few notable exceptions, the carriers were not very good at training, and have to train and retain agents. The retention rate for most of the big career agent carriers was unacceptable. I don't recall the numbers but the retention over five years was extremely low. This started in the early 1980s, and carriers that had career agents went away from being organizations that manufactured life insurance and sold it through their agents. Over time, the carriers have largely become manufacturers and they deal with independent agents who don't work for the carrier. Independent agents look for three things when they examine carriers. They look at the most aggressive underwriting, the highest commission and the lowest premium. What has happened is that agents are not loyal to companies because of the nature of the market. When carriers really moved away from career agents and became manufacturers, that put them in a position where they had to develop low-premium policies.

Historically, with whole life insurance, when I started in the business, all agents were judged by how persistent the business was, how much of the business stayed in force. With whole life insurance, the carriers wanted to stay in-force because they are getting more investment dollars as the cash value increases. When universal life was developed, instead of selling whole life insurance, the carriers' product development turned to universal life, which had very little cash value.

What the secondary market is about is universal life low premiums and term insurance, not whole life. For example, out of almost 10,000 transactions Coventry has conducted, I don't think we have bought more than 14 or 15 policies from Northwestern Mutual, because they have stayed a mutual company and focused on their historic product line with cash value. In fact, in June of 2000, the chief actuary for Northwestern Mutual, Koening, said that

if carriers continue to give less than full value then consumers would go to the secondary market. He was prophetic, and that's the reason why the market took so many years to develop. The carriers created the opportunity and we moved in to take advantage of that opportunity. The inefficiencies are, very simply, very little cash in policies. The carriers put themselves in the position of policies being sold and kept in-force.

#3 Why has the life settlement industry not done a better job at differentiating itself from STOLI?

STOLI and life settlements are two different things. The carriers have been successful, to an extent, in conflating STOLI with life settlements. That is by design, and it is designed to confuse investors, regulators and legislators. If we look at the legislative arena, which is where the battle has been fought over the last decade, the carriers go in and list to legislators a parade of horribles—all the problems with life settlements.

STOLI was created by the life insurance carriers, if you go back and look at a transaction called LILACS, it is a transaction that is pure STOLI. It was promoted by UBS with the full knowledge of the carriers. It was a structure where someone would take out, let's say a 10 million dollar policy and an annuity, and the annuity was designed to pay the premiums on the policy and a loan would be taken out. So, the annuity was designed to pay the premiums and pay the loan interest on the loan for the combination of the two. These were put into rated transactions and sold to investors.

In June of 2005, I testified at an informal hearing before a special NAIC committee and said that investor-initiated life insurance was a problem. The way to address that problem was through the life settlement acts. What happened is that the opposition to life settlements—the carriers—were very aggressive up though 2005, before there was any issue of STOLI. Then, I had two carriers approach me to see if we could develop some type of premium finance program that would lend on market value instead of surrender value. The carriers were interested in doing that. Why? Because they sold more insurance. One carrier actually wanted a share of the commissions from the policies sold. And initially it was set up that way until I said, "We won't do this." Then we had two different carriers approach us. Interestingly enough, they have been two of the carriers that are most aggressive in opposing the secondary market.

So, for a limited period of time, the carriers successfully conflated the two and literally they would talk about life settlements and refer to them as STOLI. Carriers also prohibited their agents from getting involved. In terms of how we get past that, the carriers have tried to promote STOLI by definition as a policy that is taken out with the intent to sell. Most laws that have now been passed talk about an agreement to sell and most court cases have come down on that side. Carriers have generally done poorly in the litigation; they have had a couple successes but have generally done poorly. It's just a matter of telling the story.

At the end of the day, any transaction that benefits consumers will have legs. To differentiate between a life settlement and STOLI is something that we can do, and we can show examples. There are 10 carriers that have put out statements either in the form of press releases or in their 10-Ks that say STOLI is no longer a problem, but those same carriers work in the public arena to say STOLI is a problem.

Where carriers have had success is in intimidating capital. I think PR is just a matter of getting the truth out and we are doing that increasingly. STOLI impaired the growth of the market partly because people in the secondary market did not do enough to facilitate the organic growth of the market, to be out there educating agents. We have to tell the story. No more than one percent of agents have ever done a transaction and less than 10 percent really know about them and many don't understand them because of the propaganda they have heard.

#4 The growth of the industry is dependent upon consumer awareness. What is your plan of attack for that?

I wear two hats. I am the CEO and co-founder of Coventry, and we have always done a lot of marketing, training and providing continuing education. We have had over 30,000 agents, financial planners, attorneys and accountants get CE credits over the last decade.

The other hat is that I am now the chairman of the Life Insurance Settlement Association (LISA) and the focus is on education. Education of advisors , consumers, legislators, regulators and life insurance carriers. Not long ago, I spoke to the CEO of a large life insurer that did not know that when we buy a policy, the proceeds upon policy maturity are taxable. The lack of real knowledge of the secondary market within the life insurance executive community is startling. It is fundamental knowledge.

#5 What does the future of the industry look like? Will you incorporate carriers and how do you deal with the longevity issue?

The future of the industry is extremely bright. I analogize where we are back to 2004, where the growth was very steady because of the capital markets, but the carriers' successful STOLI conflation created controversy and concerns for investors, as well as bad headlines through their PR. For a period, it actually reduced, along with capital markets, the amount of capital in the marketplace. This is a multi-sided business—there is capital on one side, there are agents, and there are consumers that submit policies. You need them all. We have to grow on the submission side of the business and we have to grow capital. We are seeing much more capital come in simply because it is a non-correlated asset with a double-digit return. I had the head of a major life company say to me, "If interest rates stay the way they are for another five years, there may not be life insurance companies anymore." This was hyperbole, but his point was that life insurance companies, with their annuities and their life policies—except for those issued in the last couple of years—have contractual obligations that, with minimum interest rates, they can't meet. So, in terms of growing life settlements, it's a matter of telling the story and letting people know that this is not unethical or anti-consumer.

Longevity is inevitable. We probably have more experience than any life insurance carrier or reinsurer in older aged mortality. We put the more than 70,000 insureds that we have underwritten through the death master file, which the carriers seem to loath. It costs nothing to use, though interestingly enough, the carriers say it is so expensive. There are two different services, one we do every week and the other every month and the cost is insignificant. In terms of longevity, when we started, the industry had what I call "belief without evidence." We believed what mortality was but we didn't have sufficient evidence. Over the years, we have developed the evidence which turned out to demonstrate that our medical underwriters' original belief was wrong. After looking at the experience and taking into account future mortality improvements, we have very good models to determine what a life expectancy will be with a high degree of confidence. We are very careful with keeping up with the literature in terms of advancements in medicine. We factor this in when we evaluate a life expectancy—not just what their health circumstances are today, but we factor in a mortality improvement for medical history and the population as a whole. That is what we estimate life expectancy to be and we have very good data that we can show to investors that will make them comfortable that we can deliver a good return.

For an investor, if everyone lived a year longer, they are still going to get a much better, higher-yield return than they would from any other alternative investment today. So we don't just look at it based on what we know and what we have seen with 70,000 lives. We look at downside cases; is it still a good investment? The answer is yes. In terms of longevity, it is a matter of real experience which we did not have before. Investors five, seven 10 years ago didn't get anything like what they had anticipated. Over the last couple of years, what we have learned, and independent medical underwriting firms, has really changed the knowledge base and makes longevity much more predictable. But nevertheless, if we are wrong by a year (which would mean 17 % less mortality than we expect), even there you would get a far better return in a non-correlated asset than insurance companies are getting or than pension plans are getting. The credibility of the underwriting is very high today.

I should say, and I think that this an appropriate time to say it, that I am a strong believer in life insurance.

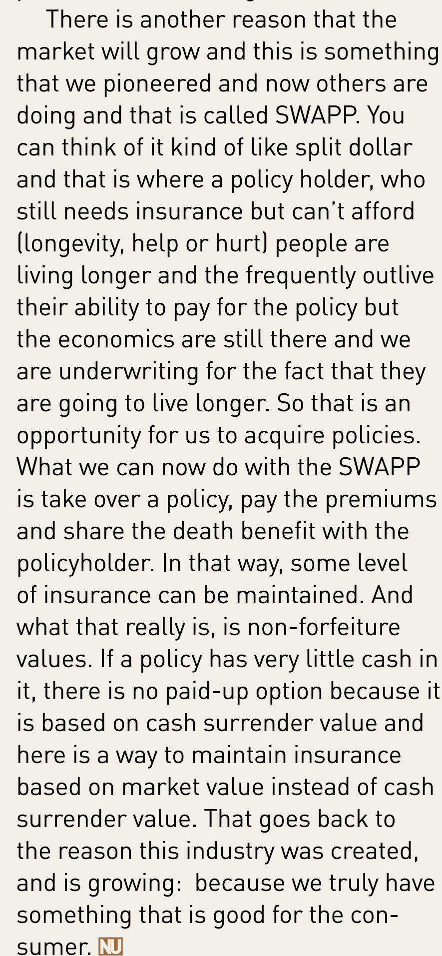
#6 What are some of the tactics that carriers currently use to stymie life settlements?

There have been two principal battlegrounds. In the legislative arena, we had carriers that did not want this market regulated, which sounds, on its face, somewhat strange. But that is because they wanted to be able to say that life settlements are an unregulated market. The legislative battles are all because the carriers wanted legislation that would either impair or do away with the market. They tried to put it into the STOLI context but the industry has been successful and with maybe two exceptions in two of the smallest states, the regulation is consistent with our being able to grow the market.

In fact, we have worked very hard with the members of the National Conference of Insurance Legislators to explain the marketplace, how settlements work, the benefits to consumers and some of the carrier conduct, and from a legislative standpoint, we have gotten very fair legislation. Our strategy has been to work with and get to know the legislators, explain what we do and ask if we can a bill introduced, and then work very hard to work with carriers to get something that is acceptable to both sides.

I should say, and I think that this an appropriate time to say it, that I am a strong believer in life insurance. I think the carriers are very shortsighted and too many of them manage by looking in the rear-view mirror instead of looking forward. They don't learn about the business. To go into a little bit of history, 100 years ago, the carriers did not approve of borrowing from the cash value. That's not the only thing they have opposed; when I started in business 40 years ago, if an agent got licensed to sell mutual funds, that agent was called unethical and was terminated by the carrier. When independent brokerage came along—because back then if you were an agent, even if your carrier did not sell a product but someone else would—you were not allowed to sell another carrier's product. So, independent brokerage was created where agents could go to an agency that represented multiple carriers with multiple products and they created an organization, the National Association of Independent Life Brokerage Agencies, and the carriers fought that aggressively. They wanted that agent only to represent them, nobody else. The carriers lost that battle. In terms of independent brokerage, that enabled carriers to have new sources of business and most carriers, almost all, one really didn't embrace independent brokerage. So, they lost that battle. Then, we can look at the 25 years I was in the business when the carriers' number one cause was to keep banks out of insurance. Every time you would pick up an industry publication there was always something about the evils of banks being in insurance. Well, ultimately banks were allowed to be in insurance and it became a major source of distribution for the life insurance industry. Those are four examples of things that the carriers fought, termed as anti-consumer, and each case the carriers lost the battle but they won in the long-term, and that is the case with life settlements.

Now in terms of carriers investing, we have invested for multiple reinsurers, including large life reinsurers, that understand that this is an opportunity. We have three carriers, one of which publicly is very opposed to settlements, that are now very interested in investing in settlements. Why? Because they need yield. The investment people are charged with getting yield and if they don't get yield they can't meet their contractual commitments which are higher than what they are earning today. It is pendulum business, there is going to be more capital than policies and vice versa. Equilibrium will always happen. A lot of capital is coming back in the market and we are seeing a steady increase, month after month, of policies that are being submitted.



There is another reason that the market will grow and this is something that we pioneered and now others are doing and that is called SWAPP. You can think of it kind of like split dollar and that is where a policy holder, who still needs insurance but can't afford (longevity, help or hurt) people are living longer and the frequently outlive their ability to pay for the policy but the economics are still there and we are underwriting for the fact that they are going to live longer. So that is an opportunity for us to acquire policies. What we can now do with the SWAPP is take over a policy, pay the premiums and share the death benefit with the policyholder. In that way, some level of insurance can be maintained. And what that really is, is non-forfeiture values. If a policy has very little cash in it, there is no paid-up option because it is based on cash surrender value and here is a way to maintain insurance based on market value instead of cash surrender value. That goes back to the reason this industry was created, and is growing: because we truly have something that is good for the consumer. NU